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In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 62

ELECTRO-CHEMICAL ENGRAVING CO., INC., PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 18–20) is unreported. The opinion of the Circuit Court of Appeals (R. 39–43) is reported in 110 F. (2d) 614.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 3, 1940 (R. 43–44). The petition for certiorari was filed May 1, 1940, and granted June 3, 1940. The jurisdiction of this Court is

conferred by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer purchased real estate and gave a purchase money mortgage. Upon default the property was sold at foreclosure. The question presented is whether the resulting loss was a capital loss subject to the limitations on deductibility contained in Section 117 of the Revenue Act of 1934. The answer to this question depends upon whether the foreclosure sale constituted a "sale" or "exchange" within the meaning of Section 117 (d).

STATUTE INVOLVED

The statutory provisions involved are identical with those contained in Appendix A to the Government's brief in *Helvering* v. *Hammel*, No. 49, present Term, except that instead of Section 23 (e) of the Revenue Act of 1934, entitled "Losses by Individuals," Section 23 (f) is pertinent here. It provides:

> (f) *Losses by Corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

STATEMENT

The facts, as stipulated (R. 32–36), may be stated as follows:

The taxpayer, a New York corporation, in 1927 purchased for factory use improved real property

located in Queens County, New York, for a total price of $150,000. The terms of the sale provided for a $50,000 down payment, the assumption of a $20,000 first mortgage indebtedness and the execution of an $80,000 purchase money second mortgage. (R. 32–33.) Subsequently, the first mortgage was discharged and thereafter petitioner defaulted in making the payments due under the purchase money mortgage. (R. 33.) In December, 1934, the assignee of the purchase money mortgage brought a foreclosure action in the New York Supreme Court in Queens County. (R. 33.) On February 6, 1935, the holder of the mortgage obtained a judgment against the taxpayer for $50,594.72 (consisting of $40,000 unpaid principal, $2,100 interest, and $8,494.72 unpaid real estate taxes and penalties), ordering a foreclosure sale. (R. 34.) Pursuant to such judgment, the mortgaged premises were sold by a referee appointed by the court on March 7, 1935, for the sum of $21,000. The purchaser was not the holder of the mortgage. On March 22, 1935, the referee executed a deed of conveyance to the purchaser. (R. 34.)

Of the price realized at the sale $20,166.39 was applied by the referee toward the debt of $50,594.72, leaving a deficiency of $30,428.33. (R. 34.) The holder of the mortgage has not sought to enforce the deficiency against the taxpayer under Section 1083–a of the New York Civil Practice Act.

(R. 34–35.)[1] After the taxpayer's basis is adjusted for capital expenditures and depreciation allowed its loss amounted to $100,771.38. (R. 19–20, 35–36.)

The Board of Tax Appeals held that ordinary income (in excess of $100,000, R. 11) received by the taxpayer in 1935 should be reduced by the full amount of this loss, rejecting the Commissioner's

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[1] That section provides in part as follows:

"No judgment shall be granted for any residue of the debt remaining unsatisfied as prescribed by the preceding section where an action to foreclose the mortgage has been or shall be commenced during the emergency or where the mortgaged property shall be sold during the emergency, except as herein provided. Simultaneously with the making of a motion for an order confirming the sale, provided such motion is made within ninety days after the date of the consummation of the sale by the delivery of the proper deed of conveyance to the purchaser in all cases where the sale is held after the date this section as hereby amended takes effect, and in all cases where the sale was held prior to the date this section as hereby amended takes effect and said sale has not heretofore been confirmed, then within ninety days from the date this section as hereby amended takes effect or within ninety days after the date of the consummation of the sale by delivery of the proper deed of conveyance to the purchaser, regardless of whether the sale was held prior or subsequent to or on the date this section as hereby amended takes effect, the party to whom such residue shall be owing may make a motion in the action for leave to enter a deficiency judgment upon notice to the party against whom such judgment is sought or the attorney who shall have appeared for such party in such action. Such notice shall be served personally or in such other manner as the court may direct. Upon such motion the court, whether or not the respondent appears, shall determine, upon affidavit or otherwise as it shall direct, the fair and reasonable market value of the mortgaged premises as of the date such prem-

contention that only $2,000 of the loss was deductible under Section 117 (d) of the Revenue Act of 1934. The Circuit Court of Appeals reversed the Board's decision.

ARGUMENT

The Government's brief in No. 49, *Helvering* v. *Hammel*, states the Government's position with respect to a set of facts similar to those at bar and the interpretation of the same controlling statutory provisions. We respectfully refer the Court to that brief, which we incorporate by reference herein. In the *Hammel* case, the taxpayer suffered loss when a contract under which she (and others) had purchased land was foreclosed, and the property sold. We have argued in our brief in that case that a foreclosure sale is a "sale" as the word is ordinarily understood, and that the loss clearly resulted from such sale since it deprived the tax-

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ises were bid in at auction or such nearest earlier date as there shall have been any market value thereof and shall make an order directing the entry of a deficiency judgment. Such deficiency judgment shall be for an amount equal to the sum of the amount owing by the party liable as determined by the judgment with interest, plus the amount owing on all prior liens and encumbrances with interest, plus costs and disbursements of the action including the referee's fee and disbursements, less the market value as determined by the court or the sale price of the property whichever shall be the higher. If no motion for a deficiency judgment shall be made as herein prescribed the proceeds of the sale regardless of amount shall be deemed to be in full satisfaction of the mortgage debt and no right to recover any deficiency in any action or proceeding shall exist."

payer of her beneficial ownership of the property. To the argument that Section 117 of the Revenue Act of 1934 does not apply to a forced sale, we pointed out that no such limitation is suggested by the language of the statute, its legislative history, or what may be presumed to have been the congressional purpose.[2] On the other hand, there is clear indication that the words "sales or exchanges" were used in a broad sense, and specifically, that involuntary transactions were intended to be included.

The slight variations between the facts in the *Hammel* case and those in the case at bar are not believed to be of significance. While Electro-Chemical Engraving Company was a mortgagor, whereas Pearl Hammel was vendee under a land contract, both taxpayers possessed the same type of capital asset, namely, the beneficial ownership of real property subject to a security interest. It is true, however, that the taxpayer in the instant case had legal title as well as beneficial ownership; the mortgagee had only a lien. *Becker* v. *McCrea*,

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[2] House Report No. 1388, 67th Congress, 4th Session, from which the taxpayer quotes (Br. 9–10) has reference to a bill (H. R. 13770) which was not enacted into law. The report is of little aid in arriving at the intent of the subsequent Congress which enacted the first capital loss provisions in the Revenue Act of 1924. In any event, the report does not indicate an intention to limit the proposed legislation to voluntary sales by the taxpayer. In fact it states (p. 5) that "The general purpose of the proposed measure is to increase the revenue by limiting deductions."

193 N. Y. 423, 86 N. E. 463; *Barson* v. *Mulligan*, 191 N. Y. 306, 84 N. E. 75.

In the instant case the mortgagee did not take the necessary steps to secure a deficiency judgment. Consequently the taxpayer apparently escaped additional loss which could have been expected to accrue from the transaction, just as Pearl Hammel escaped part of her loss by going through bankruptcy instead of paying the deficiency judgment. The effect of what occurred in the instant case was that the taxpayer was relieved of a mortgage obligation in consideration of the transfer of the property. Thus, in substance, the taxpayer is in the same position as were the taxpayers in *Rogers* v. *Commissioner*, 103 F. (2d) 790 (C. C. A. 9th), certiorari denied, 308 U. S. 580; *Pender* v. *Commissioner*, 110 F. (2d) 477 (C. C. A. 4th), certiorari denied, 310 U. S. 650, and *Wieboldt* v. *Commissioner*, 113 F. (2d) 384 (C. C. A. 7th). In each of those cases the taxpayer voluntarily relinquished the property to the mortgagee in consideration of cancellation of the mortgage debt. The important fact is that in the instant case, as well as in the *Hammel* case, it was the foreclosure sale that deprived the taxpayer of beneficial ownership, and passed it on to a new owner. Thus in each case the taxpayer's loss resulted "from" the "sale."

The taxpayer's contention (Br. 6–9) that a foreclosure sale is not a "sale" within the ordinary meaning of the word is without merit. Certainly

there was a purchase of the property and if a purchase there must have been a sale. Cf. *Butler* v. *Thomson*, 92 U. S. 412, 416. In fact, it is difficult to describe the transaction without the use of the word "sale". Compare *Helvering* v. *Midland Ins. Co.*, 300 U. S. 216. The contention fails to recognize that in our legal system it is common for an owner to lose his property by a judicial sale conducted for the primary benefit of his creditors and without his participation. Legal and other dictionaries include forced or judicial sales under the general definition of the word equally with voluntary sales. See Funk & Wagnalls New Standard Dictionary (1937 Ed.), Vol. II, p. 2162; Black's Law Dictionary (3d Ed.), p. 1578; Bouvier's Law Dictionary, Third Revision, Vol. 2, p. 2984. The ordinary definition of the word adopted by this Court in the *Five Per Cent. Cases*, 110 U. S. 471, is clearly broad enough to include an involuntary sale. There this Court stated (p. 478) that "A sale, in the ordinary sense of the word, is a transfer of property for a fixed price in money or its equivalent." The taxpayer's argument represents an attempt to narrow or limit the ordinary meaning of the term to a particular type of sale—that is, a sale carried out directly by a taxpayer. This construction is justified by neither the language nor the intent of the legislature.

The taxpayer is also in error in contending (Br. 20–23) that the foreclosure sale was not the identi-

fiable event which established its loss. On the contrary that was the necessary event which not only deprived the taxpayer of its property, but also determined whether a loss was sustained, and in the present case the exact amount. The judgment itself did not deprive the taxpayer of its interest in the property. Until the sale and the delivery of the referee's deed pursuant thereto it retained the right of possession and user. *Mitchell* v. *Bartlett*, 51 N. Y. 447; *Central Hanover Bank & Trust Co.* v. *Boccia*, 244 N. Y. App. Div. 106, 112. Furthermore, until the sale the taxpayer continued to possess its interest in the property and its right to redeem and thus prevent the loss of its property. *Nutt* v. *Cuming*, 155 N. Y. 309. The recital in the judgment purporting to bar the defendants' interest and equity of redemption, adverted to by the taxpayer (Br. 21), must be read in connection with the judgment as a whole, particularly the portion thereof ordering the sale of the premises (R. 31–32). When so read it will appear that the sale and not the judgment bars those rights. Cf. Section 1085, New York Civil Practice Act; *Nutt* v. *Cuming*, *supra*; *Sichler* v. *Look*, 93 Cal. 600, 609–611.

The sale also determined whether the taxpayer sustained a loss with respect to its investment and in this case the exact amount of the loss. This it did by establishing the amount realized by the taxpayer from the property which was applied against

its obligation. The determination of the amount realized for the property is a necessary element in determining the amount of the loss. See Revenue Act of 1934, Section 111 (a), which is quoted in Appendix A to the Government's brief in the *Hammel* case. It is true that the amount of the loss from the transaction might later be increased if within the time provided by law (see Section 1083–a, New York Civil Practice Act, *supra*) the mortgage creditor should move for and thereafter procure a deficiency judgment and the taxpayer should pay the amount and thus increase its cost basis for the property. Even that additional loss relates back to the sale, since Section 1083–a of the New York Civil Practice Act provides that the amount derived at the sale, or the market value at that time if greater, shall measure the deficiency. But no such additional loss occurred or is claimed in the present case, and it is quite clear that the sale here was the event which determined that the taxpayer's deductible loss occurred and measured the amount by establishing the amount realized by it from the property.

We submit that the taxpayer's loss in the present case was from the foreclosure sale, which was a sale of a capital asset within the legislative language and intent and that accordingly the court below correctly held that the deductible loss was limited to the amount of $2,000 by reason of the provisions of Section 117 (d) of the Revenue Act of 1934.

CONCLUSION

The decision of the Circuit Court of Appeals should be affirmed.

Respectfully submitted.

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SUPREME COURT OF THE UNITED STATES.

No. 62.—October Term, 1940.

Electro-Chemical Engraving Co., Inc., Petitioner, *vs.* Commissioner of Internal Revenue. } On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[January 6, 1941.]

Mr. Justice Stone delivered the opinion of the Court.

This is a companion case to No. 49, *Helvering* v. *Hammel*, decided this day.

The question is whether the loss suffered by petitioner on foreclosure sale of his mortgaged property, acquired for profit, may be deducted in full from gross income or only to the extent provided by § 117(d) of the 1934 Revenue Act. The statutory provisions involved are those of the 1934 Act relating to capital gains or losses, particularly "losses from sales or exchanges of capital assets" considered in the *Hammel* case which are made applicable to petitioner, a corporation, by § 23(f)(j).

The Board of Tax Appeals ruled that petitioner's loss was deductible in full from its ordinary income. The court of appeals for the second circuit reversed the Board, 110 F. (2d) 614, holding that the loss sustained by petitioner was a loss from a sale of capital assets, § 23(j), which under § 117(d) could be deducted from the gross income only to the extent of capital gains, plus $2,000. We granted certiorari, 310 U. S. 622, so that the case might be considered with the conflicting decision of the court of appeals for the sixth circuit in the *Hammel* case, 108 F. (2d) 753. For the reasons stated in our opinion in the *Hammel* case we think that this case was rightly decided below.

Affirmed.

Mr. Justice Roberts dissents.